

**SURREBUTTAL TESTIMONY OF**

**DAVID M. HERPEL, CPA**

**ON BEHALF OF**

**THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF**

**DOCKET NO. 2021-324-WS**

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

2 A. My name is David M. Herpel. My business address is 1401 Main Street, Suite 900,  
3 Columbia, South Carolina, 29201. I am employed by the South Carolina Office of  
4 Regulatory Staff (“ORS”) as an Audit Manager.

5 **Q. DID YOU FILE DIRECT TESTIMONY AND EXHIBITS RELATED TO THIS**  
6 **PROCEEDING?**

7 A. Yes. I filed direct testimony with the Public Service Commission of South Carolina  
8 (“Commission”) on February 24, 2022.

9 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS**  
10 **PROCEEDING?**

11 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of  
12 Kiawah Island Utility, Incorporated (“KIU” or “Company”) Witness Burkett relating to  
13 ORS Adjustment 19 for the calculation of KIU’s cash working capital allowance.

14 **Q. PLEASE EXPLAIN ORS ADJUSTMENT 19.**

15 A. In my direct testimony, ORS accepted the Company using a 45-day allowance to  
16 calculate cash working capital. However, ORS proposed to remove pro forma adjusted

1 purchased water in the amount of \$3,485,070 and per book bad debt expense in the amount  
2 of \$3,279 from the ORS cash working capital allowance calculation.

3 **Q. WHAT DID COMPANY WITNESS BURKETT PROPOSE IN HIS REBUTTAL**  
4 **TESTIMONY IN RESPONSE TO ORS?**

5 A. Company Witness Burkett reaffirmed the Company's calculation of cash working  
6 capital using a 45-day allowance which includes pro forma adjusted purchased water and  
7 per book bad debt expense in the calculation. Company Witness Burkett disagrees with  
8 ORS's direct testimony regarding the applicability of energy utilities excluding purchased  
9 power from their 45-day cash working capital calculation being applied here for purchased  
10 water. Witness Burkett mentions NARUC guidance and justifies his reasoning by stating  
11 that the key to why the FERC, in a 1949 case example, excluded purchased power from  
12 the calculation was because the purchased power was not paid until after revenues were  
13 received by energy utilities from their customers.<sup>1</sup> Witness Burkett argues that this same  
14 rationale cannot be applied to KIU's 45-day cash working capital calculation because "KIU  
15 pays its water bill before fully billing its customers for water."<sup>2</sup> Company Witness Burkett  
16 continues by describing the billing process for KIU by giving the example that St. Johns  
17 Water Company ("SJWC") invoices KIU at the beginning of March for February's  
18 purchased water, which is due March 15th. In his example, he states that KIU customers  
19 would be billed in cycles throughout March, for the February SJWC water bill, with  
20 respective payments due from the customers within "26 days."<sup>3</sup>

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<sup>1</sup> Company Witness Burkett Rebuttal Testimony, Page 3, Lines 10-11.

<sup>2</sup> Company Witness Burkett Rebuttal Testimony, Page 3, Lines 12-13.

<sup>3</sup> Company Witness Burkett Rebuttal Testimony, Page 3, Line 18.

**Q. DOES COMPANY WITNESS BURKETT'S REBUTTAL TESTIMONY REGARDING THE COMPANY'S INCLUSION OF PURCHASED WATER IN THE CASH WORKING CAPITAL CALCULATION CHANGE YOUR RECOMMENDATION?**

A. No. Regarding the removal of purchased water, ORS does agree with KIU Witness Burkett that jurisdictions vary when it comes to the inclusion or exclusion of purchased water in the calculation of cash working capital when using a 45-day allowance. ORS cited Pennsylvania and North Carolina as examples of jurisdictions that exclude purchased water from the 45-day cash working capital calculation.

ORS issued discovery to KIU based upon Company Witness Burkett's rebuttal testimony that KIU pays its water bill before fully billing its customers for water. Based on review of the discovery responses, KIU has four billing cycles in a month. For three of the four billing cycles, a portion of revenue is collected from customers for water used during the cycles prior to KIU having to pay SJWC for the water consumed during those cycles. This supports that there is not a 45-day lag between the time KIU pays the SJWC invoice and when KIU receives its revenue from its customers for that invoiced water. In fact, in certain instances the Company receives revenue from customers for purchased water before KIU pays the corresponding bill from SJWC. This is one reason why jurisdictions exclude purchased water and sewer from the calculation of cash working capital when using a 45-day allowance methodology and is one reason why ORS excluded purchased water from its calculation of cash working capital for KIU.

Based on ORS's review of KIU's actual billing cycles, ORS believes it would be appropriate for KIU to conduct a lead-lag study and recommends that KIU do so prior to

its next rate case. A lead-lag study is a tool that utilities can use to accurately determine the number of days that should be included in the cash working capital calculation. This is important for KIU because purchased water is the Company's largest single operating expense, and it is not clear without such a study what lag, if any, is appropriate.

**Q. DOES COMPANY WITNESS BURKETT'S REBUTTAL TESTIMONY REGARDING THE COMPANY'S INCLUSION OF BAD DEBT EXPENSE IN THE CASH WORKING CAPITAL CALCULATION CHANGE YOUR RECOMMENDATION?**

A. No. Regarding the removal of bad debt expense, ORS does agree with KIU Witness Burkett that jurisdictions vary when it comes to the inclusion or exclusion of bad debt expense from the calculation of cash working capital. However, ORS continues to recommend the exclusion of bad debt expense from the cash working capital calculation when using a 45-day allowance because bad debt expense is a non-cash expense.

The calculation of cash working capital focuses on actual cash expenses. There are no cash payments related specifically to bad debt expense that would require upfront payment from the Company while waiting for revenues from customers. For the same reasons, depreciation and deferred income taxes are excluded from the calculation of cash working capital. ORS's position is supported by the treatise *Principles of Utility Corporate Finance*, where it states: "expenses such as bad debts and other uncollectable accounts are generally excluded when working capital allowances are estimated."<sup>4</sup> Since KIU applies the 45-day methodology to calculate its cash working capital allowance to all its operating

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<sup>4</sup> Leonardo Giacchino and Jonathan Lesser, *Principles of Utility Corporate Finance*, Public Utility Reports, Inc. (2011).

and maintenance expenses, the Company already receives an allowance for those expenses.

Bad debt expense is comprised of a portion of the same expenses the 45-day methodology is applied to calculate cash working capital.

**Q. WILL YOU UPDATE YOUR SURREBUTTAL TESTIMONY BASED ON INFORMATION THAT BECOMES AVAILABLE?**

A. Yes. ORS fully reserves the right to revise its recommendations via supplemental testimony should new information become available not previously provided by the Company, or other sources, becomes available.

**Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

A. Yes, it does.